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Horace Mann Educators Corp. (HMN)

Q1 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Horace Mann Educators' Q1 2020 Investor Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Heather Wietzel, Vice President of Investor Relations. Please go ahead.

Heather J. Wietzel
Vice President-Investor Relations, Horace Mann Educators Corp.

Thank you and good morning, everyone. Welcome to Horace Mann's discussion of our first quarter results. Yesterday, we issued our earnings release and investor supplement. Copies are available on the Investors page of our website, along with our investor presentation, which was posted this morning.

Marita Zuraitis, President and Chief Executive Officer; and Bret Conklin, Executive Vice President and Chief Financial Officer will give the formal remarks on today's call.

Before turning it over to Marita, I want to note that our presentation today includes forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. The company cautions investors that any forward-looking statements include risks and uncertainties and are not guarantees of future performance. These forward-looking statements are based on management's current expectations, and we assume no obligation to update them. Actual results may differ materially due to a variety of factors, which are described in our news release and SEC filings.

In our prepared remarks, we use some non-GAAP measures. Reconciliations of these measures to the most comparable GAAP measures are available in our news release.

With that, I'll turn the call over to Marita.

Marita Zuraitis

President, Chief Executive Officer & Director, Horace Mann Educators Corp.

Thanks Heather and good morning everyone and welcome to our call. As many of you know this is Horace Mann's 75th year serving educators. We started in 1945 selling auto insurance to teachers. In the decades since we have continually added more solutions to help educators protect what they have today and prepare for a successful tomorrow. At the heart of what we do is a deep appreciation and respect for the impact that educators have on our children and our communities.

Today, marks the end of the first virtual Teacher Appreciation Week. To show our support in 2020 from an appropriate social distance, we adjusted some of our annual appreciation events, we traditionally host during the first week of May. For example, instead of hosting a lunch at a school, we're delivering lunch to teachers working from home. Instead of thanking teachers in person, we printed Thank You Teacher signs to spread across our communities. As we continue to live, work, and learn in evolving shelter in home environments to slow the spread of COVID-19, what is being asked of teachers at this moment is monumental, to provide meaningful online teaching virtually overnight, to balance the needs of students with varying degrees of stability at home, which can include lack of access to remote learning equipment or even the Internet, all while keeping parents and students up to speed with what's happening on a daily basis. They are doing incredible work.

I believe across the country there's now an even deeper appreciation for what educators do and just how vital they are to the growth and success of our communities. So while we always make it a point to thank teachers for the work they do, this week's activities have taken on a special significance and reinforced for us at Horace Mann why we're here. While our teachers are focused on preparing our children for the future, we believe they deserve someone to focus on theirs, which brings us to the unprecedented challenges our country is facing because of COVID-19.

Before I discuss our quarterly financial results and how we are thinking about the rest of 2020, I want to talk about what Horace Mann has done to support all of our stakeholder groups during these past two months. I'm especially proud of our company's nimble efficient response to ensure we continued to serve our educator customers uninterrupted. Before most states had enacted stay at home orders in March, we had already begun to transition our employee base to a work from home environment to protect their health and ensure we could continue to meet agent and customer needs.

Over a matter of weeks, we transitioned 95% of our workforce to remote working without disrupting service levels. We've also provided new resources to help employees personally. Our planning for return to office is equally deliberate focusing on the same objectives. For our educator customers, we provided a 15% credit on two months auto premium because they are driving less. For customer facing financial difficulties due to COVID-19, we are offering a payment grace period through June on auto property supplemental and life insurance payments. We're also extending personal auto coverage to those delivering food medicine and other essential goods. We don't want to just tell our customers that we're here for them during this difficult time, we want to prove it through our actions. Further to support our teachers in their professional capacity, we are providing resources for online lesson planning to educate students in a remote learning environment.

To enable our agents to work more effectively in a virtual environment we accelerated planned, technology solutions including video meetings software, enhanced e-signature capabilities, and dynamic online appointment setting tools. These upgrades make it easier for both agents and customers to conduct business online including annual policy reviews where our agents address any new or additional coverage needs. Combined with existing agent tools, these capabilities have made it possible for our agents to pivot to a completely virtual model.

To support the communities in which we live and work, we contributed $100,000 to keep kids learning, a Donor's Choose initiative to help teachers get educational materials to students at home in the highest need areas. We've also provided funding to the Central Illinois Food Bank to help keep kids fed during school closures. In addition we contributed to the local United Way COVID-19 Response Fund and a small business relief fund for the Chamber of Commerce. Our long-term success will rely on continuing to keep the well-being of our customers, employees, agents, and the community at the forefront of our conversations and decisions about business strategy.

As we navigate this unique environment, we are learning valuable lessons that we can apply even after we return to a more normal work and school routine. While the specific timeline for when the country can return to that more normal daily schedule is unclear, the Horace Mann business model remains unusually resilient for several reasons. Most importantly educators are integral to the growth and success of our communities. As the country suffers from this pandemic, educators are still teaching just now from home. In addition, the insurance and retirement solutions we provide to educators remain important to their financial well-being regardless of whether they are teaching from school or home. Educators are generally more financially conservative by nature and in times of economic disruption tend to prepare more, not less for the unexpected, protecting dependents and assets remain a priority. Of course, educators are experiencing the same changes to their day to day life as others and they aren't immune from broader economic trends.

Our first quarter results show some early impacts of the pandemic and related economic conditions. In particular, we are seeing fewer auto claims due to decreased driving. As I noted earlier, we responded with premium credits for our customers. Growth in new sales have slowed particularly those generated from in-person events at schools. In March and April, schools cancelled many in-person events as they coped with urgent COVID-19 challenges. We are seeing very early signs that school officials now have the bandwidth to work with us on new ways to give their teachers access to the financial solutions we provide. For example, schools frequently asked our agents to present onsite financial wellness workshops, which cover topics such as managing student loan debt, state pension programs, classroom crowd funding and saving for retirement. Agents are now conducting these sessions as webinars, with early signs of success.

Turning briefly to the quarter. Core earnings were up 25% over last year's first quarter, slightly ahead of what we had expected. Overall, our Property and Casualty performance was strong and we also benefited from solid earnings from the new Supplemental business. These were partially offset by lower net investment income. Generally our results reflected the strategic actions we've taken in recent years. First, the comprehensive product distribution and infrastructure improvements we've made over the past five years to better serve educators. Second, the transformational actions we completed in 2019 including the acquisitions of NTA and BCG as well as our legacy annuity reinsurance transaction. And third, recently completed profit improvement initiatives that met or exceeded our targets. For example, we achieved 6.6 points of improvement in the underlying auto loss ratio between 2017 and 2019 ahead of our 5 point target and we're seeing lower expenses across our businesses due to exceeding last year's $15 million expense reduction target.

Looking ahead, our full year core EPS guidance range remains at $2.55 to $2.75. Bret will go into details of first quarter results and the conservative approach we've used to look ahead, but we remain confident that we are well-positioned for long-term profitable growth. Further, the transformative events of recent years have been supported by our ongoing thoughtful, conservative approach to capital management. We have been preparing for an economic downturn for some time even if we didn't know what might cause it. And we have taken deliberate actions to position Horace Mann to maintain our financial strength.

We've been increasing the quality of our investment portfolio since 2017. It is now A+ rated with 95% of our core investment portfolio in investment grade holdings that continue to hold their value. Despite market volatility, we ended the quarter with about $190 million in net unrealized gains. Our consistent financial strength combined with the strength of our multi-line business model and dedication to the educator market is what has made us successful for the past 75 years in business and it's why we remain confident today that we are well positioned to reach our long-term objectives of a double digit return on equity while bringing our solutions to even more educators. Thank you.

And with that, I'll turn the call over to Bret.

Bret A. Conklin

Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.

Thanks, Marita, and good morning everyone. As Marita noted our core earnings were up 25% over last year's first quarter, slightly ahead of our expectations despite COVID-19 impacts that I'll cover when I talk about each business. Overall Property and Casualty performance was strong, the new Supplemental business made a larger than expected contribution in its third quarter as part of Horace Mann and we saw growth in annuity contract deposits in retirement.

As Marita commented our educator customers remain working and they continue to need the financial solutions Horace Mann provides. In addition our managed investment portfolio has held up well despite the current economic stresses. The modest decline in net investment income from the fourth quarter primarily impacted the Retirement and Life segments and was due to lower limited partnership income. I'll cover investments in more detail after I talk about segment performance, but our outlook for the remainder of the year includes our expectation for some additional mark to market adjustments in the alternative portfolio we're reporting for most funds is on a one quarter lag.

Our full year 2020 core EPS guidance range remains at $2.55 to $2.75, with a conservative analysis of COVID-19 scenarios that led to some changes in what we expect by segment. Due to the level of uncertainty that needs to be considered, we will refine our scenario analysis after the second quarter and would expect to update guidance when we announce second quarter results.

Looking at the business by segment, for Property and Casualty, core earnings were $26.6 million versus $15 million last year. Premiums were down slightly, as rate increases largely offset lower policy counts, while earnings saw a tax benefit due to the CARES Act treatment of carry backs of net operating losses. The reported combined ratio improved 6.9 points from last year's first quarter partially because cat losses were about one point lower. More importantly, the improvement reflected a 2.8 point benefit from the progress we've made on the underlying auto loss ratio, a 1.3 point benefit to the property underlying loss ratio largely from lower non-cat weather related and fire losses and lastly, a 1.3 point benefit from the planned reduction in run rate expenses.

The fundamental progress we've made in our Property and Casualty segment supports our strong outlook for the full year and beyond. The total combined ratio also benefited by about one point from temporary changes in policyholder behavior due to COVID-19, largely in the final weeks of the quarter and continuing into April. We know you've heard this from many other insurers, so to quickly recap, stay at home and other guidelines implemented across the United States in March and April changed driving behavior a lot. Miles driven correlates directly to auto loss frequency. According to data from HMDrive, our telematics app, daily customer miles driven were roughly flat during January and most of February. Miles rose a bit until mid-March when stay-at-home orders became common. After mid-March, we saw a sharp decline in miles driven that correlates directly with our drop in auto loss frequency.

We continue to watch this data closely as states begin to open up their economies to monitor new impacts on driving behavior. We recognize the lower level of driving with a 15% premium credit for two months for current policyholders. The timing and manner of that credit will vary depending on regulatory approval. Our revised outlook for $61 million to $66 million in P&C segment earnings for the year also anticipates less driving in these early weeks of the second quarter. Generally, every 10% deviation in monthly auto frequency from our expectations represents about $2 million in pre-tax earnings. Our analysis does not include offsets from other factors, such as the potential for higher severity.

While we continue to assume retention remains steady and new rate increases averaging the low single digits across auto and property, net written premiums for 2020 are likely to be below 2019. This reflects premium refunds and slower new business due to the pandemic. We expect this to reverse over time with policy counts beginning to rise in 2021. We also continue to assume the full year cat load will again be in the range of $45 million to $55 million or about 7.5 points on the full year combined ratio, about half of which would typically occur in the second quarter.

Turning to the Supplemental segment, NTA has been part of Horace Mann since last July. This quarter they added $33 million in premiums representing approximately 14% of total first quarter premiums in contract charges. Segment income was $10.5 million or about a third of core earnings illustrating the diversification value it provides. Net investment income on the Supplemental portfolio was $3.5 million in the first quarter. Supplemental sales were $3.7 million in the first quarter, primarily added in January and February. New relationships at NTA have traditionally come from in-person events at schools. In this environment we're accelerating the integration of the NTA agents into our distribution system, so they have access to more tools to reach customers. We expect sales to return to a more normal trajectory in the coming months.

Premium persistency was stable at about 89% with almost 300,000 policies in force. As we've said policyholder retention for this business is relatively stable quarter to quarter. For the quarter, we saw favorable trends and reserves on the acquired book of business. In addition we believe policyholders have temporarily changed their behavior because of COVID-19. For example, policyholders may have opted to treat minor accidental injuries at home rather than visit a healthcare facility. We saw some of this near the end of the first and into the second quarter, although we expect to return to normal loss patterns at some point. Due to these factors, the pre-tax profit margin was above our longer term expectations at 36%. For the remainder of the year, we continue to expect the pre-tax margin will be in the low-to-mid 20s, with full year core earnings in the range of $31 million to $33 million, slightly ahead of previous expectations because of the strong first quarter.

For the Life segment, sales were below last year's first quarter, primarily because of lower sales of single premium products. Sales of recurring premium products were stable. Core earnings for the quarter also reflected lower net investment income. We now expect the segment should deliver $10 million to $12 million in ex-DAC earnings in 2020 with mortality remaining near expectations. For the Retirement segment, this is the final quarter in which we have complex year-over-year comparisons because of our annuity reinsurance transaction. That transaction in 2019 addressed the interest rate risk of a legacy block of individual annuities, with a minimum crediting rate of 4.5% and also released capital used to purchase NTA.

Our Supplemental Retirement Solutions remain a core need for educators. Annuity contract deposits were up nearly 10% for the quarter and they continue to be an important part of our product set. Annuities appeal to the financial objectives of our educator customers, while complementing our growing suite of fee-based products. For the first quarter, Retirement earnings ex-DAC were $2.3 million, below our expectations entirely because of the lower than expected net investment income, which I will cover in a moment. We now expect core earnings for 2020 to be in the range of $22 million to $24 million. Run rate expenses are lower which will be a long-term positive.

Turning to investments, the events of the first quarter made two things very clear. One, our portfolio is well-positioned to weather the near-term market volatility in COVID-19 induced economic downturn. And two, we will be able to capitalize on the market disruptions in a manner similar to what we did in the financial crisis.

Over the past two years, we have significantly reduced risk in the portfolio by taking actions to prepare for a turn in the credit cycle. We believed corporate leverage particularly for BBB corporate credit and high yield was excessive. Over this period we've reduced our historical allocation to investment grade corporates by nearly 15% to about 20% of our current portfolio. We focused CLO investments on AA and AAA areas of the capital structure where credit enhancement levels prevent principal losses even in extremely severe stress scenarios.

We remain disciplined and allocated purchases to government agency securities and highly rated investment grade corporate and municipal issuers. To enhance yield, we modestly expanded our senior commercial mortgage loan fund allocations; they comprise less than 2% of our portfolio at March 31. We also continue to increase the size of our private credit limited partnership portfolio. These actions have created a resilient portfolio that we believe will perform well on a relative basis in the current environment. We have about $450 million of exposures to the asset classes most impacted by the COVID-19 induced economic downturn, specifically energy, retail, aviation and leisure and travel. They spread across nearly 200 issuers, nearly all of which are investment grade with an average rating of A-. They represent less than 7% of our portfolio with the average price for the holdings at the end of March at 93% of amortized cost. We remain comfortable holding these securities based on our current views, which are informed by our rigorous highly sophisticated stress testing of the portfolio. This stress testing informs our portfolio selection in two ways. One, dispositions to avoid emerging risk; and two, purchases that will boost portfolio yields for years to come.

During the first quarter, we reported net realized trading gains of $4.3 million, somewhat offset by $3.7 million of impairment losses. The majority of the impairment losses were intent to sell decisions related to energy positions. In addition, we had mark-to-market losses of $14.5 million on equity securities primarily in the P&C portfolio. We expect these to reverse as equity markets recover and saw about an $8 million rebound in April. The core fixed income portfolio had a yield of 4.51% in the first quarter, up slightly from 4.36% at year-end. Our new money rate was nearly 4% and based on current market conditions, we anticipate purchases near that level for the remainder of the year. This is above our previous guidance of 3.5%.

We expect to maintain a spread in our Retirement portfolio of about 200 bps to 220 bps for the full year despite the first quarter dip to about 150 bps. The decline in the first quarter was largely related to lower limited partnership income. Our limited partnership portfolio experienced mark-to-market price volatility in a handful of funds that have a structured credit focus as a result of the spread widening that occurred in March. We do not view these as permanent credit losses and have seen a modest rebound in April results. The remainder of our limited partnership and commercial mortgage loan fund portfolio continues to perform well, but we have reduced our outlook given market volatility. Our long-term target return for this asset class is 6% to 7%. We've now tempered expectations for this year to around 4%. As a result, we now expect the limited partnership earnings to total $10 million to $15 million for the full year.

We now expect total 2020 net investment income from the managed investment portfolios will be around $260 million. Accreted investment income on the deposit asset on reinsurance is on track. You will recall this amount is an actuarial driven calculation and should not be affected in the short-term by market volatility or prevailing interest rates. Putting the pieces together, total 2020 net investment income is now expected to be between $350 million and $355 million. That expectation is reflected in the segment by segment outlook summarized in our investor presentation and in our core EPS guidance range of $2.55 to $2.75.

Before closing, it's important to remember that the solid foundation we have put in place over the past several years continues to support us as we face the challenges of this unprecedented period. We're pleased with the strong results of the first quarter and our favorable outlook. We continue to manage our capital conservatively knowing that we will be able to move forward with three accretive uses for excess capital when the time is right. Number one, growing our business at returns that meet or exceed our ROE targets; number two returning a significant portion of annual earnings back to shareholders via a compelling dividend; and third opportunistically buying back shares when market conditions warrant.

We continue to believe that our RBC target of 425% for each of our subsidiaries is appropriate and along with a debt to total capitalization ratio under 25% support the insurance financial strength ratings of A or equivalent from each of our four rating agencies. As we look beyond the next few quarters we continue to see opportunity to expand return on equity through the integration of NTA as we fulfill our cross-sell objectives and align their investment portfolio with our current strategies. Further the solid foundation we've built in the past few years will support market share expansion with ROE benefiting from growth across the businesses. Thank you.

And with that, I'll turn it back over to Marita.

Marita Zuraitis

President, Chief Executive Officer & Director, Horace Mann Educators Corp.

Thank you, Bret. Bret and I will handle the majority of the Q&A in this virtual environment. For detailed questions on the line are Matt Sharpe, Distribution and Business Development, Wade Rugenstein, Operations and Supplemental and Ryan Greenier, Corporate Finance. In addition Mark Desrochers and Mike Weckenbrock have joined our call group for the first time. Mark has been Horace Mann's Chief Corporate Actuary for about five years and formerly ran the personal line operations for the Hanover Insurance Group. He's taken the reins of our Property and Casualty business effective April 1st. Mike has been running our Retirement business for two years and added our Life business to his responsibilities last fall.

Now, let me turn the call back to Heather to start the Q&A.

QUESTION AND ANSWER SECTION

Operator: We will now begin our question-and-answer session. [Operator Instructions] Our first question comes from Gary Ransom with Dowling & Partners. Please go ahead.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC
Q

Yes, good morning, everyone.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

Hey Gary.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC
Q

I was wondering, if you could give a little more color on the frequency trends and the severity trends. Maybe my question is actually more about severity. Just wondering what you're seeing both on the auto repair side as well as on the injury side?

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

Sure Gary. This is Bret. Why don't I start and then I'll have Mark add a little color commentary after my opening remarks. But just to share our auto frequency was actually down about 10% for the full month of March, which that's equal to roughly the $2 million or about one point on the first quarter combined P&C ratio. But you really can't think about that as a blended full month data point. We do know from our data that miles driven did tick up in early March before dropping off substantially for the last two weeks. Miles driven definitely remained lower in April, but May and June are more uncertain because of the more variables as people in various geographies across the company – country get back on the road on different schedules. Obviously, there could be increases in severity to offset those decreases in frequency. But Mark, you may want to talk more about that and what you're seeing on the data?

Mark Desrochers
Senior Vice President, Chief Corporate Actuary & Acting Head-Property and Casualty business, Horace Mann Educators Corp.
A

Sure. Thanks, Bret. Yeah, first I'll start with we've been able to leverage the information from HMDrive, our telematics app to get better – much better real-time understanding of driving behavior. As Bret mentioned, we saw miles driven pretty flat January and February. First half of March kind of a run up quite frankly until mid-March. And then we saw a pretty sharp decline over the next couple of weeks until it flattened out as this – the stay at home orders took place. I'd say we do expect to see miles driven increase from its bottoming out point, especially as summer approaches and families are going on vacation and engaging in other activities. And they may be reluctant to use other forms of transportation and driving may become more common. In fact, some of the early data we're seeing with HMDrive would indicate in the last couple of weeks we've actually seen an uptick in driving behavior that's starting to drive a little bit of a bounce back in the frequency.

You bring up a good point about the severity while we look at that $2 million of impact from a 10% frequency savings. We can't look at that in a vacuum and there is some potential severity impact, it's a little early to tell exactly how that's impacting us, especially where the drop-off really happened over the first couple of weeks of the last couple of weeks of March and we're just starting to adjudicate all those claims. But I would say that given the lack of traffic density what we expect to see is that the average severity is likely to be ticking up given that there's certainly less fender bender-type accidents out there. And that the accidents that are happening tend to be a little bit more severe. The other thing we have to think about in the longer term is the impact of the economy, for example, with unemployment is high as it is, I have some expectation that we'll start to see some creep in the level of uninsured or underinsured motorist coverage and our clients as teachers, they tend to be employed more often they tend to buy more coverage; so they'll have that those higher limits for uninsured motorist coverage and that's something I expect that we could see some uptick in the near future. So I hope that addresses your question.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Yes, it does. Just one follow up on injury claims that may have been still outstanding. Are you seeing any trend toward trying to settle those sooner?

Mark Desrochers
Senior Vice President, Chief Corporate Actuary & Acting Head-Property and Casualty business, Horace Mann Educators Corp.

A

We are. Yeah, there is certainly attorneys and clients are more available and more anxious to settle claims, so there is obviously been some impact in the acceleration of settlement of those claims and so, we'll continue to watch that pretty closely.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Okay. Thank you. And then, I'll just ask one more on a different subject. Bret, you mentioned new money at 4% and we had previously been guided 3.5%. Can you add a little bit more on what actually changed to get that or maybe I misunderstood, but maybe could you add a little color on that?

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.

A

Yeah, well, I actually have Ryan Greenier take that.

Ryan E. Greenier
Vice President-Finance, Horace Mann Educators Corp.

A

Good morning, Gary.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Good morning.

Ryan E. Greenier
Vice President-Finance, Horace Mann Educators Corp.

A

It really was a tale of two halves in the quarter. Our new money rate had been running in the high 2s to low 3s for most of January and February. But when we saw the market volatility creep into the market, we saw multiple opportunities to put money to work at yields north of 4%. Very high quality paper, seeing new issuances of AA rated companies, issue at 4.5%, as well as some very modest allocations to BBB and high yield paper at yields north of 5.5% to 6%. So we like the trends we're seeing, we're being disciplined and we do think that this current spread environment will persist for most of 2020.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

All right. Well, thank you very much for that.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.

A

Thanks, Gary.

Operator: Our next question comes from John Barnidge with Sandler O'Neill (sic) [Piper Sandler] (37:04). Please go ahead.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you. What is your sensitivity on an earnings perspective to 100,000 US COVID deaths? Is that something other companies have offered?

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.

A

Yeah, John, this is Bret. I can take that and let me just start with some general comments with respect to mortality exposure and I think it's safe to say our Life business you know the mortality exposure is minimal. We are conservative life insurance company and we're well prepared to handle any increase in claims and yes, we have done stress testing to confirm. For the record, we've only had two claims related to COVID through today. And I would say the first one only mentioned coronavirus on the death certificate. It could have been just flu but either way it's been obviously very insignificant. When we look at our annual claims volume, there are about $50 million to $55 million per year, a 10% increase in that mortality would be about additional $5 million of claims and well within our surplus levels. But with current deaths in the US at about 70,000, if we took our two claims gross them up and extrapolate it, you'd probably come to about three. So it's really minimal at this point maybe a couple other color commentary points, the average face of the age 70-plus population on our books is only about $30,000 and the 5% of the face of our book is over 70 years old. We're not licensed in New York. Educator base is not focused in the major urban areas and educators have been working from home.

So I think our fact pattern is pretty good as it relates to the exposure to COVID-19.

John Barnidge
Analyst, Piper Sandler & Co.

Q

That's fantastic. Thank you. So the tax benefit from the CARES Act, will that recur to a lesser extent the remaining quarters of the year, as that's something a couple of other companies had suggested could happen?

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.

A

Yeah. John for us, it's kind of a once and done that benefit of roughly just south of $3 million is a discrete item. We're allowed to carry back some net operating losses from the 2018 years back to older tax years that have the 35% rate versus 21%. So, we were obviously able to generate a larger benefit, but that's a one-time item.

John Barnidge
Analyst, Piper Sandler & Co.
Q

Fantastic. My last question, I'll re-queue, is there any commentary you'd offer around cat loss activities so far in 2Q 2020? Thanks for the answers.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

Sure. As you recall and I think I even had it in my prepared remarks in the script 2Q is usually our heaviest cat quarter of the year, roughly 50% of the cats occur in the second quarter. April cats to-date have been consistent with our expectations for the second quarter. So nothing unusual there and I believe in my prepared remarks in confirming our guidance, we said the cat load would still be at 7.5% for the full year.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

And that's knowing what we know already...

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

Correct.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

...about April.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

Correct.

John Barnidge
Analyst, Piper Sandler & Co.
Q

Thank you very much for the answers.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

Sure.

Operator: [Operator Instructions] Our next question comes from Meyer Shields with KBW. Please go ahead.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Great. Thank you. Good morning.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

Good morning, Meyer.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hi. So, I think you mentioned that the part of the improvement in the homeowners loss ratio was not actually weather, can you talk about the impact of shelter in place orders on frequency because I've heard the theories going in both directions?

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

I'm going to turn that over to Mark, since I know he has the specific detail. Mark?

Mark Desrochers
Senior Vice President, Chief Corporate Actuary & Acting Head-Property and Casualty business, Horace Mann Educators Corp.

A

Yeah, I mean early on we haven't seen any significant changes from a frequency standpoint on homeowners. It's our daily claims volume bouncing around within the normal range that we've seen. So we've yet to see any, anything significant directly related to COVID.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Perfect. Second question is one of the – again, do you see the – what's out there, that we're going to see less shopping for insurance overall, is there anything you can talk about how that impacts specifically the business that you transfer to other carriers, say non- standard to other unusual risks?

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Yeah, Meyer. It's Marita. I – we are seeing absolutely that trend as far as less shopping. When you think about our business the constant reminder that you've got a homogeneous set of customers, they know who we are. We actually have seen because these teachers are home working from home virtually. We have obviously made more outbound calls and our agents are seeing the response rate from the educators higher because they're able to take those calls because they have a little more flexibility in their schedules.

We also with the work we did with our virtual Teachers Appreciation Week for example and our increase in social media outreach, we're actually seeing an increase of inbound calls for quote. But we are not – are at the retentions holding quite well. I think at the beginning of all of this, the last thing on people's minds was shopping for auto insurance. But I think as people fall into a more comfortable schedule, some of that shopping might actually return as they get more comfortable with their surroundings and the situation, but we're finding good access to our customers in this time and they're certainly finding us.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Excellent. Thank you so much.

Operator: Our next question comes from Gary Ransom from Dowling & Partners. Please go ahead.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Yeah, I have one more on that subject of shopping and teaching from home. And this is maybe a longer term question, but the way this is going, there may be some change in how teaching actually happens in the future. Maybe, this is a big test for virtual classrooms and I guess, I just wanted to ask how that – thinking about that kind of a future, how might that change what you need to prepare for?

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Yeah, I mean, there's two things I think about the first thing I think about is our business model and I think we've learned a lot already due to this very unusual situation for all of us. It certainly has reinforced for us that although school access is beneficial, it's not required. We're learning a lot about, I mentioned the social media, the inbound calls the outbound calls. But we are finding that the virtual tools that we already had and in many cases accelerated new tools are working well. We're seeing some early success whether it's the Zoom, access, webinars for 403(b) enrollment or student loan solutions, workshops online, we're reaching many of our educators quite efficiently.

I mean obviously we do have some agents who might be more heavily reliant on in school sales. But this is an interesting forcing mechanism even for them where they're learning the new technology embracing things like electronic calendars that we had out there for a while and some of the more traditional agents are harder to get them to use these tools. Now they are and they're learning to like them and they're learning to see the value of how many educators they can actually attract with these tools. So in some way for some it's been a forcing mechanism. You also have to think about the fact that although this did quicken our summer schedule, our agents are used to having a certain routine over the summer when teachers aren't teaching. So it's a little bit of an early summer for us, no doubt about it.

I think that in our Supplemental world, you will see some stress on sales tend to be more heavily worksite and that's an industry phenomena not just Horace Mann. NTA was however building and rolling out remote E-app processes, online applications systems, direct mail campaigns. Many of those were already built and we're working really hard to accelerate the deployment. We do expect to see some stress on NTA sales in the short-term. But that, we believe that's going to be temporary. We also think that there's potentially pent-up demand for these types of products, especially people feeling the effect of what out-of-pocket expenses do and driven by unexpected events.

I think you're seeing a lot of advertising from some of our larger competitors and actually that's helpful for us with our products as well. On another front, I'm thinking about educators and what this will do to educators at large. We spend a lot of time with school districts with superintendents with principals and we're hearing the whole gamut from some school districts actually have to hire more teachers in the fall if they're going to shrink classroom size and provide appropriate social distancing, all the way to some districts may actually have some financial constraints where they will shrink the amount of their teachers because a budgetary constraints and may go to more of a split schedule type of environment and kind of everything in between. But for us, although we have about 1 million or so educator customers, there's still an awful lot of headroom for us, but we're watching that pretty closely.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

That's great. Thank you very much. And just maybe one follow-up on telematics also. Have you seen any opportunity for pushing that a little bit harder or greater acceptance of that product, which has been noted by a couple of your auto peers?

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

Yeah. Absolutely. And with the onset of this really have talked in off a lot to our agents and our customers about a great opportunity to drive penetration there. Mark, any additional comments?

Mark Desrochers
Senior Vice President, Chief Corporate Actuary & Acting Head-Property and Casualty business, Horace Mann Educators Corp.
A

Yeah, Marita. What I'd add is – I mean, obviously we're operating off a small base. We just get it started in the last year, but we have seen year-to-date over the first four months of the year about a 25% increase in the number of registered users and half of that or nearly half of that has come in the last month. So we are certainly seeing more interest and an uptick.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC
Q

Interesting. Just as an aside, did you know that you don't drive your score goes to a 100%?

Mark Desrochers
Senior Vice President, Chief Corporate Actuary & Acting Head-Property and Casualty business, Horace Mann Educators Corp.
A

No I was not aware of that.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC
Q

You should be having on your phone.

Mark Desrochers
Senior Vice President, Chief Corporate Actuary & Acting Head-Property and Casualty business, Horace Mann Educators Corp.
A

I do. I actually have this. I have. I do have it now on my phone, but have not been able to drive.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC
Q

Yeah. Anyway thank you very much.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

Thank you.

Operator: Our next question comes from Matt Carletti with JMP. Please go ahead.

Matthew J. Carletti
Analyst, JMP Securities LLC
Q

Hey. Thanks. Good morning.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

Good morning.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

Good morning, Matt.

Matthew J. Carletti
Analyst, JMP Securities LLC
Q

Gary snagged one of mine there on kind of operating in this environment, but I have one other and it relates to the investment income, particularly the guidance for – I think it was down about [ph] $15 million (50:46) year-over-year and the alternatives. Just hope you could help us the timing a little bit in terms of, is there a lag on those alternatives, what does it look like and kind of just trying to get the shape over the next few quarters right within that guidance?

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

Yeah. I'll have Ryan take that, that, Matt but there is definite timing to that. And obviously...

Matthew J. Carletti
Analyst, JMP Securities LLC
Q

Sure.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

...I think even in my remarks we were operating with a one month lag. So I'll let Ryan expand upon that.

Ryan E. Greenier
Vice President-Finance, Horace Mann Educators Corp.
A

Sure. Good morning.

Matthew J. Carletti
Analyst, JMP Securities LLC
Q

Good morning.

Ryan E. Greenier
Vice President-Finance, Horace Mann Educators Corp.
A

Our alternative portfolio is comprised of a little bit more than 30 funds and it's spread across various strategies and structures. But what I would say is the vast majority of those funds are on a one quarter lag. So when we look at the results in the first quarter, the loss that we posted of $4.1 million on the limited partnership portfolio was comprised of one specific fund strategy across three funds. That strategy is they invest opportunistically in public investment grade structured credit. That sector of the fixed income market had significant volatility in March and we saw a significant spread widening. We marked that to market and it was $6.4 million of losses on those funds. We did see some rebound in April, but obviously not to that magnitude.

When I think about the remainder of the LP portfolio, which we'll be reporting on a one quarter lag, those funds include senior commercial mortgage loan funds or more typical alternative asset classes like infrastructure debt and equity, private credit, private equity. And these are different strategies and they're exposed to different drivers from a valuation perspective. We reduced our annual limited partnership earnings assumption to a range of $10 million to $15 million, down from about $25 million previously because that does incorporate some expectations for valuation pressure, which we would expect to see in second quarter.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

All right. Perfect. That's very helpful. So the second – in second quarter we'll see most of what happened in first quarter and then any...

[indiscernible] (52:58)

Ryan E. Greenier
Vice President-Finance, Horace Mann Educators Corp.

A

Yeah. I mean I don't know that crystal ball...

[indiscernible] (52:59)

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

...part of that that kind of rebound or that might have already a liquidity has come in and so forth that would whatever that might be, were probably be more of Q3 and then we got to see what happens from that.

Ryan E. Greenier
Vice President-Finance, Horace Mann Educators Corp.

A

Yeah, I mean, the biggest drivers are going to be risk premiums, lower public market comps, both in the equity and debt markets. And just challenges in commercial real estate and general economic stress are really the drivers of it. But from where we sit today, things look better now than they did at the end of March.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Yeah, perfect. And then, a follow on. I apologize, if it was – I missed the very early comments. Did you guys – there was a lot of dislocation. I mean, did you find a lot opportunities to – you guys have de-risked, I think you talked about it a lot. Kind of you've been, you didn't know when it was going to come, but you positioned the portfolio for something like this at more recessionary time over the past several years. When it arrived, can you talk at all about maybe some of the actions you took opportunistically as you saw assets in the market that you viewed as very mispriced or so forth or was that really due to liquidity and otherwise not really an opportunity?

Ryan E. Greenier
Vice President-Finance, Horace Mann Educators Corp.

A

No, Matt. We clearly saw an opportunity, but we approached it in a disciplined manner. We do believe that there will continue to be significant equity market volatility, as the economic stresses of the pandemic become more fully apparent. That will translate volatility in the fixed income markets. Our longer term expectation is for interest rates to remain at the low levels we see today or perhaps even go lower. However, we do expect significant spread widening to persists. We put up about $85 million to work opportunistically and you can see that's a fraction of our overall portfolio value. Most of that was in highly rated investment grade corporates, where we saw yields north 4.5% on household names like Exxon and Verizon and names that we liked.

We did add opportunistically to BBB and some fallen angels. We saw yields north of 6.5% on Kraft Heinz Foods for instance, another really resilient pick for the portfolio. We also did add to some structured credit and saw yields approaching 10% that was all high quality structured credit that appeared to be mispriced based on our stress testing. We'll continue to take the same approach. This is the approach that we used back in 2008 and 2009. We were disciplined and we layered in higher yielding assets, some of the benefit of that continues to this day in the portfolio.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

And in light of those opportunities that Ryan just went through, we did increase our original new money rate plan of 3.5% to 4%. So we feel good about where we are there based on the money that Ryan and teams put to work here recently.

Matthew J. Carletti
Analyst, JMP Securities LLC
Q

Great. Thank you for the color, and congrats on a nice start to the year.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

Thank you.

Bret A. Conklin
Executive Vice President & Chief Financial Officer, Horace Mann Educators Corp.
A

Thanks Matt.

Operator: This concludes our question-and-answer session. I would now like to turn the conference back over to Heather Wietzel for any closing remarks.

Heather J. Wietzel
Vice President-Investor Relations, Horace Mann Educators Corp.

Thank you, Brandon. Thank you everyone for joining us today. We are absolutely looking forward to connecting with all of you in the coming days and weeks. It may have to be virtual, but it'll be a good chance to talk through what we're doing in the business strategy. So feel free to touch base and we'll do what we can. Thank you again.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.